The equity bears are squealing again

The bell-weather S&P500 rose an impressive 3.57% over the week (to 2,786.57), taking the year-to-date gain to 4.51%, driven by a combination of (a) the reality of Trump's steel and aluminium tariffs being softened by the opportunity of exemptions from them, (b) the shock but welcome news regarding a planned meeting between Presidents Donald Trump and Kim Jong Un, and (c) block-buster US non-farm payrolls data for February. The above delivered a shot-in-the-arm to equity markets, with the MSCI World index closing 2.76% higher over the week in a move to more 'risk-on', with the usual havens side-lined. The real stand-out performance came from the NASDAQ 100 index (+4.26%), the purer technology measure vs. its stable-mate, the NASDAQ Composite, which closed 4.17% higher - with both at new all-time closing highs, very significant technically. In line with our recommendations in FAB Global Investment Outlook 2018, we remain overweight in technology, which would be "driven by a multitude of growth possibilities". The overweight in tech has clearly worked for the year-to-date, and new all-time highs mean zero overhead technical resistance. **The NASDAQ Composite is ahead by 9.52% for the year-to-date, while the NASDAQ 100 is up 11.02%.**

"The 'miss' on wages growth in the US non-farm payrolls helped cap inflation expectations"

US non-farm payrolls were very strong for February, increasing by 313,000 last month, easily beating forecasts of about 2000,000 (analysts usually quote a 180-200K number when they expect an 'average' increase - or when they don't know). Without doubt this was a stand-out number, partially signposted by the good ADP (private payrolls) data earlier in the week. The job gains reflected both broad growth across industrial sectors, and the largest rise in construction jobs since 2007. Average hourly earnings were 0.15% higher, month-on-month, at $26.75, less than the 0.3% posted in January, contributing to the year-on-year increase in average hourly earnings moderating to 2.6%, down from 2.8% in January. We try not to draw too many conclusions from one months' data; it brings to mind the way commentators saw the 2.8% number last month, which was extrapolated to inflation beginning to take off - yet with little consideration of the lack of pricing power in often highly competitive markets. The US economy is continuing to do very well, with the Federal Reserve Bank of New York projecting real GDP growth of 2.83% annualized in the current quarter. At the same time, 'core' inflation appears to be under control (at close to 1.5%, year-on-year), and we expect this to remain under 2% for the next few years. With respectable growth, combined with only moderate inflation, this continues to be a 'Goldilocks' US economic environment, and one in which the excesses that usually signal the end of cycles appear to be absent. Recent PMI data from the US services sector tells a very upbeat story (with readings in the high 50's), and let's not forget this represents about 75% of the economy.

"The FAB Asset Allocation Committee remains solidly behind equities as an asset class"

In European equities, the STOXX Europe 600 index closed 3.05% higher over the week, with some rebound potential following political developments of recent weeks, and despite the US tariffs. European equities lack the technology component of other global indices, and we continue to favour the sub-class as an overweight mainly for its 'value' attributes. In Japanese equities, the TOPIX index closed just 0.42% higher over the week, calming after its initial jump on the North Korea news; the recent strength of the yen has been unhelpful to all-important Japanese exports. Asia-Pacific markets took heart from the proposed US-North Korea meeting, which did really take markets (and maybe also US Secretary of State, Rex Tillerson) by surprise. The MSCI Asia-Pacific (ex-Japan) index closed 1.70% higher last week. Chinese stocks as measured by the CSI 300 index closed 2.30% higher over the week. **The FAB Asset Allocation Committee met last week and remains committed to its overweight in global equities.**

"A large short position in Treasury bond futures is helping to keep the US 10-year yield below 3%"

In global bonds, the Bloomberg Barclays Global-Aggregate index (unhedged) closed 0.19% lower (at 487.3794), notably underperforming equities on the one hand, yet tantalizingly refusing to signal a bearish reversal in absolute terms on the other. The 10-year US Treasury yield closed three basis points firmer over the week (at 2.8938%), with the sheer strength of the NFP number almost certainly being drowned-out by the moderation in wage growth helping to keep inflation expectations subdued - and the 3% yield level out of reach. **The more policy-sensitive US 2-year Treasury yield firmed slightly (to 2.2580%) over the week, with its recent technical action suggesting this could be 'as high as it goes' for a while.**

"The health of the MSCI Emerging Market Currencies index underlines the EM story"

In foreign exchange markets the US

dollar was left in limbo and trendless, with bullish and bearish factors canceling each other out. Until last week's market chatter about trade wars, some in the markets had begun to think in terms of four Fed rate hikes this year (although we still think it will be three). Looking at USD 2-year forward swaps, market expectations now appear to be in the region of 'five hikes and done' over that period, and this could be about right - with significant pain mainly concentrated in highly-leveraged entities, and their counterparties. Following the ECB policy meeting, Mario Draghi, its president, delivered the message that the ECB would end its easing bias, yet did so with a typically dovish twist (it's his duty to avoid allowing the markets to mark the euro up very far, which would harm export competitiveness). The yen was hit in a small way as improving risk appetite elsewhere reduced the attractiveness of presumed havens, including the Japanese currency, and gold. The euro/dollar pair closed at $1.2306, for a small fall on the week, while the yen/dollar closed at ¥106.82, with the dollar just over 1% firmer vs. the yen. The Bank of Japan left monetary policy on hold last week. In EM currencies, the MSCI Emerging Markets index (at 1,717.95) closed the week holding just below recent all-time highs, underlining why we continue to like EM equities. In commodities, steel and aluminium prices fell in the wake of the tariffs; aluminium prices fell by 1.3%, with steel prices falling 6.8%. Brent crude closed just over a dollar/barrel higher (at $65.49), with the rally in risk assets overshadowing data showing that US crude inventories stocks rose in the previous week (by 2.4 million barrels). Spot Brent has in recent weeks been trading at a steadier premium to West Texas Intermediate, within a range of $3-4. **We wouldn't be surprised to find ourselves increasing our Brent crude price target range from $70 later this year, to perhaps $80 looking into 2019, recognizing continuing fundamental improvement.**

"Trump's tariffs look like a negotiating ploy – and 'son of the TPP' has just started without him"

INVESTMENT SUMMARY:

(1) The US-North Korea meeting being planned - despite some justified caution - might yet pave the way to a safer world. Without getting too carried away, selected risk asset prices - obviously especially in the Asia-Pacific region - could benefit via lower risk-related discount rates. North Korea has made such moves before over the years, certainly, but we think China will play the 'honest broker' to good effect, and might even host the talks.

(2) When markets go to new highs, as selected equity indices did last week, this is not something to be afraid of unless it's clearly based on trading volumes and valuations based on mindless greed. Unfortunately the best equity gains do tend to come in the 'final', greed phase.

(3) Apart from maintaining its global equity overweight (in all regions with the exception of MENA, which remains neutral), the Asset Allocation Committee last week voted to hedge its euro exposure i.e. it expects the euro to underperform the US dollar for the time being, on a mainly technical basis.

(4) In addition, the discussion regarding overweighting G3 government/Investment Grade bonds (as mentioned in last week's report) on a purely tactical basis continued at the AA. In essence the approximate 3% level on the US 10-year Treasury was still thought unlikely to give way for the moment, and provides a good trading opportunity down to a target yield of about 2.65%.

(5) In looking to action the above bond trade, although the Committee saw it as attractive when viewed in isolation, there was far less agreement about trimming the global equity position to pay for it - which would have been necessary given little cash being available from other sources e.g. hedge funds, which were already very underweight in the asset allocation grid. We hope our readers will find this interesting, and as an example of the kinds of decisions that have to be made.

(6) Considering the arguments relating to Trump's tariffs, for the reasons and numbers given in last week's report (e.g. steel and aluminium only accounting for about 2% of US imports, and in reality being of little consequence to China) we are not yet concerned about the possibility of a trade war. Also, if the EU does put tariffs on Harley Davidsons and Levi's, for instance, these would probably still sell at the higher prices, with buyers of these goods in effect paying the tariffs, and being able and/or willing to do so. Trump's tariffs increasingly look like a negotiating ploy.

(7) The 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership' (CPTPP) has just been signed by the TPP countries, ex-the US, and will reduce tariffs in countries that together account for more than 13% of the global economy, amounting to about $10 trillion in GDP. The Asia-Pacific (ex-Japan) region remains our most enthusiastic equity overweight, and with increasing amounts of trade expected within its own area.

(8) **In line with the global economic and investment thesis detailed in Outlook 2018, and despite Donald Trump's continuing domestic tribulations, the current elongated economic cycle still looks intact - and could be well into 2020.**

Alain.Marckus@bankfab.com
Clint.Dove@bankfab.com

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